STATE OF CALFORNIA
ELECTRICITY OVERSIGHT BOARD

Gray Davis, Governor

April 15, 2002

VIA E-MAIL

Hon. Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, D.C. 20426

Re: California Electricity Oversight Board v. Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources
Docket No. EL02- 62-000

Dear Ms. Salas:

The Electricity Oversight Board hereby submits an electronic version for filing of its Response to Answers Opposing and Motions to Dismiss Long-Term Contract Complaint in the above-referenced docket.

Thank you for your assistance.

Sincerely,

Grant A. Rosenblum
Staff Counsel
Electricity Oversight Board

Enclosures
cc: Official Service List – EL00-60-000 and EL02-62-000

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Electricity Oversight Board, Complainant v. Sellers of Energy and Capacity Under Long-Term Contracts With the California Department of Water Resources, Respondents	)	Docket No. EL02-62-000

RESPONSE OF THE CALIFORNIA ELECTRICITY OVERSIGHT BOARD TO ANSWERS OPPOSING AND MOTIONS TO DISMISS LONG-TERM CONTRACT COMPLAINT

The California Electricity Oversight Board (California Board) hereby responds to motions to dismiss and further requests leave to respond to answers filed by various respondents and/or intervenors in opposition to the complaint initiating the above referenced proceeding.[1] The California Board's response should assist the Commission in considering various assertions raised in this proceeding and therefore is appropriate.[2]

[1] Parties filing substantive answers and protests in this proceeding include the Independent Energy Producers Association, Electric Power Supply Association, the Western Power Trading Forum, Soledad Energy LLC, Allegheny Energy Supply Company LLC, Calpeak Project Companies, GWF Energy LLC, PacifiCorp Power Marketing, Inc., El Paso Merchant Energy, L.P., Mirant Americas Energy Marketing, L.P., Coral Power LLC, Dynegy Power Marketing, Inc., El Segundo Power LLC, Long Beach Generation LLC, Cabrillo Power I LLC, Fresno Cogeneration Partners L.P., Wellhead Power Gates LLC, Wellhead Power Panoche LLC, Morgan Stanley Capital Group, Inc., Clearwood Electric Company LLC, Colton Power L.P., PG&E Energy Trading-Power L.P., Williams Energy Marketing & Trading Company, Constellation Power Source, Inc., High Desert Power Project LLC, Calpine Energy Services, L.P., Reliant Energy Power Generation, Inc., Reliant Energy Services, Inc., Duke Energy North America LLC, Duke

I.

The California Board's Complaint Should Be Treated, At A Minimum, Similar To Complaints Underlying The "Nevada Power" Order

This proceeding no longer exists in a vacuum. In its *Order Setting Complaints for Hearing, Establishing Hearing Procedures, and Consolidating Proceedings,* 99 FERC ¶ 61,047 (April 11, 2002) (Nevada Power Order), the Commission addressed allegations virtually indistinguishable from those advanced by the California Board in this docket that dysfunctions in the California electricity spot markets caused long-term contracts negotiated in bilateral markets to be unjust and unreasonable. The Nevada Power Order compelled the Commission to balance the value of certainty and stability in commercial contracts with its unequivocal mandate to ensure that all rates are just and reasonable. In so doing, the Commission recognized that the extraordinary and unprecedented breakdown of the California spot energy markets during 2001 warrants, at a minimum, granting parties the opportunity to demonstrate by full evidentiary hearing that long-term bilateral contract rates and conditions negotiated during the California power crisis violated the Federal Power Act.

Energy Trading & Marketing LLC, Sempra Energy Resources, and Sunrise Power Company (collectively "Sellers").

[2] Notwithstanding Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), the Commission has accepted answers to protests and answers that assist the Commission's understanding and resolution of the issues raised in a complaint. See, e.g., *Atlantic City Electricity Company,* 90 FERC ¶ 61,268 at 61,898 (2000) [allowing answer to protest "since it has helped to clarify the issues"); *Allegheny Electric Cooperative, Inc. v. Pennsylvania Electric Company*, 92 FERC ¶ 61,206 at 61,693 (2000) [accepting answer to an answer "because it assist[ed] in [the Commission's] understanding of the issues raised]. The California Board's response will serve these purposes and will also help the Commission "to achieve a complete, accurate, and fully argued record." *Mojave Pipeline Co.,* 70 FERC ¶ 61,296 (1995), *modified,* 72 FERC ¶ 61,167 (1995), *vacated on other grounds,* 75 FERC ¶ 61,108 (1996), 78 FERC ¶ 61,163 (1997). The Answer should accordingly be accepted as a response to the various answers, protests and other pleadings filed in this proceeding. In this regard, on April 5, 2002, the Commission issued a Notice of Extension in this proceeding and in Docket No. EL02-60-000 extending the date for the California Board to file a response to April 15, 2002.

The balance struck by the Commission in the Nevada Power Order is appropriate. The continued movement toward market mechanisms to deliver electric energy requires a vigilant regulator. As Commission Massey noted, "there will be no viable path to achieve our pro-competitive goals if consumers lack confidence that this Commission will insist that long-term contracts are just and reasonable." Similarly, the potential threat that contract instability will impede capital investment in generating and transmission resources has been effectively blunted by the Commission by expressly linking the relief granted in Nevada Power Order to the extraordinary circumstances of the California situation.[3]

The rationale of the Nevada Power Order applies with even greater force to the complaint filed by the California Board. With the financial collapse of California's investor-owned utilities (IOUs) in January 2001, California was confronted with an unprecedented power procurement responsibility. Literally overnight, the California Energy Resources Scheduling Division of the Department of Water Resources (CERS) was required to immediately purchase approximately 6,000,000 MWh/month, or some 8,000 MWh/hour of every hour of every day to meet the IOUs' net short position or Californians would face massive blackouts. Unlike the load serving entities involved in the Nevada Power Order, CERS did not have an existing portfolio of resources, or prior opportunity, to mitigate exposure to the spot markets. Rather, CERS was confronted with

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[3] The argument that going forward with this proceeding may result in Sellers' withdrawing from California is without merit. If the allegations in the complaint are true, Sellers will continue to be granted the opportunity to earn substantial profits through future sales to California that would simply reflect commercially reasonable levels. Rational economic actors in a competitive market would respond to a situation where they could make reasonable profits by offering their services, not withholding them.

developing a portfolio from scratch in an admittedly dysfunctional market where market power had driven spot market prices to dizzying heights.

As previously recognized by the Commission, this breakdown in the California spot market effectively eliminated "the single most important element for disciplining longer term transactions."[4] Simply put, CERS could not escape market power by moving its procurement efforts to the forward markets. Sellers exacted through long-term contracts with CERS the same amount of market-power rents, only amortized over the term of the contract, that would have been exacted in the spot market. The Nevada Power Order implicitly recognizes that the sophistication of the buyer is irrelevant. Indeed, Sellers' reliance on the presumed sophistication of the CERS negotiators emphasizes the point – even sophisticated negotiators cannot avoid unjust and unreasonable terms if conditions of market power exist.

The Nevada Power Order reflects the Commission's determination that the question whether the dysfunctional spot markets adversely affected the long-term bilateral markets so as to warrant modification of individual contracts is of sufficient importance to outweigh the sanctity of contracts and to require a full evidentiary hearing. The California Board's complaint raises the same substantive issues and thus deserves similar treatment by the Commission.[5]

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[4] *AEP Power Marketing, et al.*, 97 FERC ¶ 61,219 (2001) at 61,972.

[5] Sellers argue that the Commission's initiation of the Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000 precludes the California Board or any other complainant from submitting evidence related to market manipulation by Enron or other market participant. Such a limitation would be inconsistent with the Nevada Power Order. That order provides that the judge is to consider "the totality of purchases and sales and the conditions present at the time the contracts were entered into." Slip. op. at 14. Thus, it is the clear intent of the Commission to

II.

The Nevada Power Order Rejects Contentions That The Only Remedy Is To Challenge The Grant Of Sellers' Market-Based Rates

Several Sellers contend that the California Board's complaint rests on the improper premise that an individual transaction entered into under market-based rate authority may be challenged while the particular seller's market-based rate authority remains intact.[6] In other words, Sellers argue that once market-based rate authority has been granted, contracts executed pursuant to that authority may not be individually challenged by a section 206 complaint, but instead can only be indirectly attacked by challenging the seller's market-based rate authority itself. By allowing the Nevada Power complaints to proceed to hearing on the issue of "whether modification of any individual contract at issue is warranted," the Nevada Power Order necessarily rejects the Sellers' argument.[7]

Further, the Sellers' conclusion that market-based rates granted pursuant to the abandoned "hub and spoke" analysis would conclusively ensure just and reasonable rates for all discrete transactions has been expressly discarded by the Commission. On November 20, 2001, the Commission concluded that, "because of significant structural changes and corporate realignments that have occurred and continue to occur in the electric industry, our hub and spoke analysis no longer adequately protects customers

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allow the parties to present any evidence relevant to the overall market conditions and that the creation of such record will be complimentary to the efforts of the Commission in Docket No. PA02-2-000.

[6] See, Constellation at p. 21.

[7] Nevada Power Order, slip. op. at 13.

against generation market power in all circumstances."[8] Each of the contracts at issue here were negotiated pursuant to market-based rate authority analyzed under the now discredited hub and spoke methodology.

Prior Commission pronouncements in *San Diego Gas & Electric Company, et al.,* Docket Nos. EL00-95, et al. (San Diego Docket) recognized the imperfection of market power screens and that despite satisfaction of a screen, market power could exist in some "circumstances." The December 15 Order in the San Diego Docket found that the structural flaws in the California market in conjunction with an imbalance of supply and demand "have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy under certain conditions."[9] This was true notwithstanding that all sellers into the California market possessed market-based rate authority.

Under the Sellers' argument, the only recourse available to the Commission for the exercise of market power (even discrete episodes) or isolated unjust and unreasonable transactions would be to impose the sweeping remedy of conditioning the seller's market-based rate authority.[10] The Commission would be limited to "hunting houseflies with a cannon." The Commission, in its July 25 Order establishing the scope of and methodology for calculating refunds related to transactions in the spot markets operated

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8 *AEP Power Marketing, Inc.,* 97 FERC ¶ 61,219, slip. op. at 7.

9 December 15 Order, at 61,984.

10 There is a question regarding the efficacy of any remedy available under the Seller's theory. If the only sanction available to the Commission is modification of the seller's market-based rate authority upon the refund effective date, it is not at all clear whether the unjust and unreasonable contract, executed while market-based rate authority was unencumbered, could be reformed. In contrast, it is clear that a challenge to the contract itself would permit reformation to all executory elements of the contract as of the refund effective date.

by the CAISO and CALPX, has clearly rejected that the grant of market-based rate authority was intended to exclude all subsequent market-based transactions from Section 206 review. Thus, the argument that the California Board's complaint must be dismissed as improperly targeting individual transactions should be rejected as bad policy, inconsistent with Commission precedent and its policing obligations under section 206.[11]

III.

The California Board Has Standing To Bring This Complaint

Several Sellers assert that the California Board lacks standing to prosecute this Complaint. Sellers' arguments can be summarily rejected.

First, it is asserted that the California Board lacks the "legal authority" to challenge the long-term contracts under *California law*. In other words, the argument alleges the California Board has exceeded its *own state statutory authority* by filing the complaint. Resolution of this issue does not require interpretation of Commission regulations[12] or jurisprudence on standing, but instead requires the Commission to interpret the scope and powers granted to the California Board by the California Legislature. The Commission does not construe state law and will not "second-guess" a state entity's "view of its own authority … under the laws of its own state."[13]

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[11] The Commission's *Order Denying Rehearing,* 98 FERC ¶ 61,330 (March 20, 2002) in GWF Energy LLC, Docket Nos. ER02-42-001 (GWF Order), does appear to include language that would suggest that a determination of the justness and reasonableness of an individual transaction is unnecessary "because such determination has, in effect, already been made in the acceptance, and continued effectiveness, of the market-based rate tariff pursuant to which GWF's long-term service agreement is filed." GWF Order, slip. op. at 6. As noted, this statement directly conflicts with the result of the Nevada Power Order and would greatly reduce the Commission's ability to police market transactions. Accordingly, the California Board requests that the Commission either reject the GWF Order or clarify its meaning in the context of this proceeding.

[12] See, 18 C.F.R. § 385.206.

[13] *American Electric Power Company and Central and South West Corporation,* 87 FERC ¶ 61,274 (1999); see also, *KN Wattenberg Transmission Limited Liability Company,* 93 FERC ¶ 61,041 (2000) ["We

Second, Sellers submit that the California Board lacks standing because the Commission has already concluded in its December 19 Order that the California Board "has no authority to evaluate wholesale transmission rates."[14] Again, this argument rests on a fundamental misconception of standing, the role of California law on the issue of standing and the California Board's right to protect California interests. The Commission unequivocally possesses the right to evaluate or determine the legal sufficiency of wholesale rates. The filing of the complaint acknowledges this reality and is wholly consistent with the December 19 Order. However, the question as to who actually adjudicates the legality of wholesale rates is irrelevant to the question of standing or who can petition the Commission to exercise its jurisdiction over wholesale rates. That latter question in the context of a state agency first rests on state law and the scope of the agency's statutory authority, which, as noted, is beyond the purview of the Commission, and second on application of the Commission's procedural regulations and opinions governing standing. Thus, reliance on the December 19 Order is without merit.

Third, Sellers argue that the California Board has no separate interest to represent apart from the CERS and therefore has no standing.[15] On its face, this argument makes little sense. Rule 206 of the Commission's Rules of Practice and Procedure provides that "any person may file a complaint … for … any alleged wrong over which the

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affirm our finding in our March 2000 Order on remand that the Colorado PUC's certification of its jurisdiction is conclusive evidence of its authority. In that order, and here, '[w]e decline to inject ourselves into a dispute over the interpretations of state law' regarding the reach of the Colorado PUC's jurisdiction."].

[14] *San Diego Gas & Electric Company,* 97 FERC ¶ 61,275 (2001) ("December 19 Order").

[15] The Sellers appear to want their cake and eat it too. On the one hand, they argue that the California Board and CDWR are the same party for purposes of determining the standard of review under the Mobile-Sierra doctrine, but also the same party for standing purposes. As noted, if the California Board can be said to stand in the shoes of the CDWR for purposes of Mobile-Sierra, then it certainly possesses interests that are affected by unjust and unreasonable rates exacted under the long-term contracts.

Commission may have jurisdiction."[16] The Commission has consistently applied Rule 206 to permit any person, including a state or state entity, to file a complaint even where that person does not possess a direct interest in the transaction, so long as the person is "adversely affected" by the actions that are the subject of the complaint.[17] If the Sellers' position is true, which the California Board does not concede as discussed below, and the California Board's interests are "not separate" from those of the CERS, there can be no dispute that its interests were adversely affected by anti-competitive conditions that dictated the terms and conditions of the long-term contracts.

The Sellers' argument reduces to a complaint that another state entity, namely CERS, should have initiated this proceeding. That preference is, as the Sellers recognize, an "internal California political question" that is nonjusticable by the Commission. Unlike the case of *Schabarum v. California Legislature,* 60 Cal.App.4th 1205, 1213-1215 (1998), relied upon by Constellation, the Commission is not being asked to resolve this preference or any other dispute among California state entities. Here, the CERS has neither objected nor intervened in this proceeding. Accordingly, there is no dispute between CERS and the California Board on which the Commission must abstain from deciding such that the policy concerns underlying the so-called political question doctrine are inapplicable. What remains is a dispute directly within the Commission's jurisdiction – the justness and reasonableness of wholesale rates charged under the long-term contracts.

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16 18 C.F.R. § 385.206.

17 *Southern Union Gas Company v. Northern Natural Gas Company,* 71 FERC ¶ 61,198 (1995).

Notwithstanding the logical inconsistency of defeating standing by merging the interests of the California Board and CERS, the argument fails because the California Board and CERS do, in fact, possess separate interests and identities. The CERS' authority to procure electric energy on behalf of California consumers is set forth at California Public Utilities Code section 80100, et seq. The California Board's authority to initiate litigation to ensure that the interests of California's citizens and consumers are protected in relation to costs for electric transmission and generation during periods of peak demand is set forth at California Public Utilities Code sections 335(e) and 341(c). None of the foregoing sections grant the ability of either state agency to direct or otherwise restrict the pursuit of the other's statutory responsibilities.

As noted, the California Board's authority encompasses representing the interests of California consumers. Here, the California Board is seeking refunds on behalf of California ratepayers for whom CERS purchased power under long-term contracts. California ratepayers bear the burden of unjust and unreasonable long-term contract rates and any refund proceeds awarded in this proceeding will, under California law, flow back to California's consumers.[18] The indirect claim of these retail ratepayers asserted by the California Board cannot be defeated or compromised in any way by the failure of CERS to assert a refund claim in its own name.

[18] CERS operates under the provisions of A.B. No. 1, enacted February 1, 2001. Among other things, the statute establishes the Department of Water Resources Electric Power Fund, and requires that all revenues payable to CERS under the statute be deposited in that Fund. CERS may sell power acquired under the statute to retail end use customers, *at not more than its acquisition costs*, including related costs of transmission, scheduling, etc. Payments from the fund may be made only for purposes authorized by the statute. Accordingly, any refunds paid to CERS will be deposited in the first instance in the Electric Power Fund, but then will flow back to retail end use customers in order to satisfy the statute's requirement that CERS charge those end use customers no more than its acquisition costs for power.

There can be no doubt that the California Board has standing to assert the refund claim of retail ratepayers associated with CERS long-term purchases. The Federal Power Act specifically authorizes the Commission to admit as a party in a proceeding "any representative of interested consumers."[19] As such, the Commission traditionally has permitted state consumer representatives automatic party status in proceedings,[20] and has permitted states' attorneys general, state commissions and other state agencies that represent consumer interests standing to litigate wholesale rate issues.[21]

Significantly, in recognizing the standing of state agencies to litigate wholesale rates, the Commission has made it quite clear that the indirect claim of a state agency on behalf of retail consumers is distinct from and not in any way dependent upon the participation or non-participation of the direct purchasers who serve those same end user retail customers. Thus, in *United Gas Pipeline Co.*,[22] where the issue presented involved imposition of take-or-pay cost liability on local distribution companies ("LDCs") (the direct purchasers from pipelines), the Commission recognized that LDCs themselves may choose to forego any challenge to a pipeline's prudence in incurring take-or-pay costs, but that state agencies representing the end user customers of those LDCs are entitled to

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19 16 U.S.C. § 825g(a).

20 18 C.F.R. § 385.214(a)(2) ("Any State Commission is a party to any proceeding upon filing a notice of intervention in that proceeding, if the notice is filed within the period established under Rule 210(b)").

21 *Williams Gas Pipelines Central, Inc.,* 94 FERC ¶ 61.285 (2001) (Missouri Public Service Commission permitted to intervene in enforcement action under Natural Gas Act because pipeline was major supplier of natural gas transmission and storage service to Missouri customers, and Missouri Public Service Commission, as public representative of retail consumers in Missouri, was permitted to intervene); *New England Power Co.,* 51 FERC ¶ 61,219 (1990) (Attorney General of Commonwealth of Massachusetts and New Hampshire Public Utilities Commission permitted to intervene out of time in electric rate proceeding, given, *inter alia*, "the interests of the constituencies they represent. . . .").

22 45 FERC ¶ 61,335 (1988).

take a different view. As the Commission held in that case, state agencies in such instances are permitted to pursue litigation on behalf of indirect consumer interests, even though the LDC -- the actual direct purchaser -- chooses not to do so. [23] Thus, the fact that the direct purchaser (in this case, CERS) may not pursue a claim in a wholesale rate refund proceeding, does not operate to prevent consumer representatives (in this case, the California Board) from pursuing an indirect claim on behalf of consumers that is associated with the exact same underlying wholesale purchasers.

IV.

The Complaint Does Not Collaterally Attack Prior Commission Orders

Sellers assert that the California Board complaint represents an impermissible collateral attack on prior Commission orders that rejected price mitigation for California power transactions in forward markets and reversion to cost-of-service rate-making. The argument distorts Commission findings, ignores express Commission guidance to rely on section 206 complaint procedures to challenge the justness and reasonableness of the contracts, and misunderstands the complaint's reference to marginal cost benchmarks. Consequently, the argument lacks merit and must be disregarded.

The Sellers are simply incorrect that the Commission has conclusively precluded review of CERS' long-term contracts. In March 2001, the California Board filed a motion in the San Diego Docket requesting that the Commission extend the mitigation measures articulated in the December 15 Order to CERS bilateral transactions.[24] In

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[23] 45 FERC ¶ 61,335.

[24] "Motion of the California Electricity Oversight Board for Clarification and Extension of Specific Aspects of the December 15, 2000 Order in Docket Nos. EL00-95-000 et al.," Docket Nos. EL00-95, et al. (March 1, 2001). The motion, in fact, focused on short-term transactions: "Although, the ongoing issue of creditworthiness of California's investor-owned utilities primarily accounts for the DWR's present role in

denying the California Board's motion in the July 25 Order, the Commission did not purport to immunize specific long-term bilateral contracts from Commission scrutiny under the Federal Power Act. The Commission simply rejected *automatic* application of refund mechanisms to bilateral transactions to avoid discouraging new bilateral transactions.[25] Conversely, the Commission explicitly invited challenges on a contract by contract basis by saying, "[i]f DWR (or any other party) believes any of its contracts are unjust and unreasonable, it may file a complaint under FPA section 206 to seek modification of such contracts."[26]

The basis for the Commission's refusal to extend mitigation to bilateral transactions articulated in the June 19 Order and December 19 Order involved the circumscribed scope of the Section 206 investigation instigated in the San Diego Docket. As the Commission noted in the June 19 Order, "[t]he Section 206 proceeding involving the ISO was limited to the ISO's and PX's real-time markets and did not extend to bilateral markets."[27] Similarly, in the December 19 Order, the Commission reasoned,

> We are not convinced that any other short-term bilateral contracts may be made subject to refunds under the July 25 Order. As discussed above,

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procuring energy to meet California's needs, the demise of the CalPX markets (a direct result of the December 15, 2000 Order) deprives the DWR of a short-term market and forces the DWR to make its short-term energy purchases directly rather than through the CalPX markets. These short-term transactions are equally susceptible to market power abuses and unjust and unreasonable rates, the market harms the Commission sought to remedy through the price mitigation measures in its December 15, 2000 Order. As such, these short-term energy transactions entered into between these same public utility sellers and the DWR should be subject to the transaction reporting requirements and refund potential measures implemented in the December 15, 2000 Order."

25 *San Diego Gas & Electric Company, et al.,* 96 FERC ¶ 61, 120 (2001) (July 25 Order) at 61,515.

26 *Id.* at 61,515, fn. 59.

27 *San Diego Gas & Electric Company, et al.,* 95 FERC ¶ 61,418 (2001) (June 19 Order) at 62,556. The June 19 Order further found the "[p]arties have not provided the justification for extending the scope of our investigation or mitigation to bilateral transactions other than spot markets." In so doing, the Commission's statement cannot be reasonably read to conclusively preclude subsequent offers of proof, such as that submitted by the California Board in this proceeding.

> bilateral transactions are beyond the scope of the SDG&E proceeding. SDG&E's initial complaint targeted only sales of energy and Ancillary Services into markets operated by the ISO and PX, not bilateral sales. Although the Commission found it appropriate after the DOE section 202(c) order to apply prospective price mitigation to bilateral sport markets in the WSCC, including California, this action was taken as part of the section 206 investigation of the WSCC markets. Imposing refund liability on bilateral transactions in the SDG&E proceeding is not permitted.[28]

Thus, the Commission has not adjudicated the issue of the justness and reasonableness of the long-term contracts entered into by the CDWR or whether mitigation may be appropriate as applied to specifically contested transactions.

The Commission's refusal to reinstitute cost-of-service ratemaking is extraneous to the California Board's complaint. The California Board is not seeking to reimpose cost-of-service ratemaking. Instead, the California Board's complaint, consistent with Commission precedent, simply utilizes a cost of capacity benchmark to emulate prices that would be produced by a competitive market for long-term power and capacity.

V.

The CERS Contracts Should Be Reviewed Under A Just and Reasonable Standard

As in the Nevada Power proceedings, the parties here have extensively argued whether the Mobile-Sierra "public interest" burden of proof or a "just and reasonable" standard applies to any review of the CERS contracts. In the Nevada Power Order, the Commission concluded an insufficient record precluded resolution of the issue and included the standard of review as a matter for hearing. Here, however, the record is sufficient for the Commission to confirm that the just and reasonable standard properly

[28] San Diego Gas & Electric Company, et al., 97 FERC ¶ 61,275 (2001) (December 19 Order), slip. op. at 55.

applies. There has been no substantive review by the FERC of any of the challenged contracts. Nor is the California Board a "party" to the CERS contracts. Thus, the Commission should employ the just and reasonable standard, which is applicable to assess a "third-party" complaint regarding a contract that has not undergone prior Commission review. Moreover, the parties to the contract cannot bind the Commission to using the public interest standard when considering the interests of such non-parties.

A. The FERC Has Not Substantively Reviewed the Contracts

Various Sellers argue that because some of the disputed contracts have been filed and accepted at the Commission under market-based authority, the contracts have already been initially "reviewed" by the Commission and thus are not eligible to being challenged under a "just and reasonable" standard.[29] To begin, many of the contracts have not been filed at all with the Commission. Equally significant, the Commission recently confirmed that it performs no substantive review of each long-term service agreement submitted to the Commission, but rather that the agreements are submitted for "informational purposes only." In fact, the Commission expressly declined to "examine every long-term service agreement" filed in compliance with reporting conditions imposed upon the grant of market-based rate authority.[30] Accordingly, it is clear that the Commission has not ensured that any challenged contract is just and reasonable or otherwise determined whether the guidelines set forth in the December 15, 2000, Order have been satisfied.

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[29] *E.g.,* Calpeak at 25-26; Calpine at 34.

[30] GWF Order, slip. op. at 4-5.

Sellers are incorrect that application of a just and reasonable standard would lead to chaos by allowing all contracts filed under market-based authority to be reopened. As noted above, the unprecedented circumstances surrounding the signing of the challenged contracts, and the failure of the California electricity market in late 2000 and early 2001 elevates the present contract from general instances of buyer's remorse. The circumstances giving rise to the CERS contracts are so unique that the Commission need not be concerned that utilizing the "just and reasonable" standard to alter contracts on file will cause the Commission to be drown in a deluge of section 206 filings.

B. The California Board is a Third Party to the Contracts Between CERS and the Generators And Thus Can Assert that the Contracts are Not Just and Reasonable

The California Board is not a party to the CERS contracts. Sellers argue that the California Board is not a "third party" to the contracts because both the California Board and CERS are agencies of the State of California. Sellers' argument continues that language in some of the contracts that CERS would not challenge the contracts binds the California Board or that other contract language purporting to eliminate the section 206 rights of all other entities of California government necessarily constitutes a waiver by the California Board. E.g., Williams 24-26; Wellhead at 6; Calpine at 20-21. The California Board's status as a state agency does not in and of itself render it a party, rather than a non-party or third party, to the CDWR contracts merely because CERS is also a state agency.

Most Respondents do not cite any law, but merely argue that both the California Board and CERS represent "California" or the state government and thus CERS' promise not to challenge the contracts at the Commission – or promise that no other state agency

could challenge the contracts at the Commission – bars the current complaint. However, CERS did not have any authority to bind the California Board. Moreover, this argument clearly disregards the plain language of the contracts themselves, showing CERS or CDWR to be the only "party" with which the generators negotiated and contracted,[31] and frequently specifying that no rights are granted to "third parties."[32]

C. If the Commission Declines to Employ the Just and Reasonable Standard, It Can Employ the Public Interest Standard to Abrogate or Modify the Contracts

Even if the Commission finds it proper to employ the more stringent "public interest" standard to evaluate the contracts rather than the "just and reasonable" standard, sufficient factors are present to warrant a finding that these contracts are not in the "public interest." The public interest standard is not "practically insurmountable" in the context of this complaint. As explained in Northeast Utilities Service Co. v. FERC, 55 F.3d 686, 691-692 (1st. Cir. 1995):

> Papago has unfortunately been identified with the notion that the "public interest" standard of review is "practically insurmountable," regardless of the circumstances of the case. This is the misreading that NUSCO presses upon us as the law of the case. We do not think that Papago, read in context, means that the "public interest" standard is practically insurmountable in all circumstances. It all depends on whose ox is gored and how the public interest is affected…. we reject NUSCO's argument that under the law of the case the public interest standard should be considered "practically insurmountable" in all circumstances.

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[31] In every contract, the "buyer" or "Party B" is defined solely as California Department of Water Resources (CDWR), except for Sunrise's contract, in which CDWR is defined as "the buyer" and "Party A." In no contract is any entity other than CDWR specified as the "buyer."

[32] See, e.g.,Clearwood Contract, § 10.13: "Third Party Beneficiaries. This Agreement shall not be construed to create rights in, or grant remedies to, any third party as a beneficiary of this Agreement or of any duty, obligation or undertaking established herein …."; Soledad Contract, § 10.13; Sempra Contract, § 10.12; Imperial Contract, § 10.13; all Calpeak Contracts, § 12.15.

This is especially true here. The Commission, expressly and through its actions, compelled CERS to seek long-term contracts without first mitigating California's spot markets. As the Nevada Power Order recognized, the "extraordinary circumstances" surrounding the California spot and long-run electricity markets in early 2001 warrant a hearing to determine whether or not the contracts were the result of the exercise of market power by sellers. Sufficient evidence has been presented to require that a hearing be held to evaluate whether modifications to these contracts are in the "public interest."

VI.

The Commission Should Include Within The Scope Of Any Hearing All Contracts Included In The California Board's Complaint

The complaints underlying the Nevada Power Order only sought Commission review for contracts "entered into" between November 1, 2000 through June 20, 2001, coinciding with commencement of the Commission's West-wide mitigation measures. Consequently, the hearing established by the Nevada Power Order encompasses only those contracts entered into during that time period.[33]

The California Board's complaint is not temporally limited. The California Board seeks review of all CERS contracts that contain unjust and unreasonable rates and/or conditions. The Commission should not assume that all market power in the forward bilateral markets dissipated with the advent of West-wide mitigation. The California Board, as well as the California Public Utilities Commission, has presented sufficient evidence establishing that the rates in each contested contract substantially exceed any

[33] Nevada Power Order, slip. op. at 14 , fn. 14.

reasonable competitive benchmark, regardless of when executed, as well as contain unconscionable non-price terms.

More important, each of the challenged contracts was negotiated prior to the imposition of West-wide mitigation. All of the contracts subject to the California Board's complaint were negotiated by means of an initial "letter of intent" that set forth basic terms, including price, and subsequently by execution of the "contract" that added terms and conditions other than those previously contained in the letter of intent. The letter of intent for all contracts contested by the complaint were signed by the parties prior to June 20, 2001, except for the following: Exhibit 17 – Clearwood Energy Company; Exhibit 29 – Wellhead Power LLC (Panoche); Exhibit 30 – Wellhead Power LLC (Gates); Exhibit 31 – Fresno Cogeneration Partners LP. The letters of intent for those projects were signed on June 22, 2001. Thus, the negotiation of all of the contracts took place in period when California's spot markets were being ravaged by market power. The California Board, therefore, should be permitted to prove, and each particular Seller permitted to rebut, that a specific contract referenced in the complaint is unjust and unreasonable.

To the extent the Commission elects to define the scope of any hearing by reference to contract date, the clause "entered into" as used in the Nevada Power Order must be clarified. As noted, given that all of the contracts subject to the California Board's complaint were negotiated by means of an initial letter of intent, the date of the letter of intent must constitute the operative date for any just and reasonable analysis.

VII.

The Motions To Bifurcate Should Be Denied

Motions to bifurcate were filed on at least two bases: (1) contracts executed after June 19, 2001, or imposition of West-wide mitigation, should be treated separately and (2) purportedly cost-based contracts should be segregated. Both justifications should fail.

There is no basis for establishing separate procedures for contracts executed after June 19, 2001. There is no dispute that the Commission's West-wide mitigation had a significant effect on the market. However, the price terms of every contract which was executed after June 19, and for which a motion to bifurcate has been made, were negotiated earlier by means of executed letters of intent.[34] For instance, PacificCorp Power Marketing signed its letter of intent on February 12, 2001. The pricing of the Sunrise contract originated prior to April 2001, during the negotiations of the Edison MOU.[35]

Sunrise's claim that its contract should be addressed in a separate proceeding because it is allegedly "cost-based" should similarly be rejected. Sunrise concedes that its contract was in fact entered into pursuant to its market rate authority.[36] Moreover, there has been no adjudication as to the reasonableness of Sunrise purported costs. That issue is, in fact, the core of this proceeding and must be determined. There is simply no basis for establishing a separate proceeding as to Sunrise or as to any other individual

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[34] Those parties with letters of intent signed after June 19, 2001, are not seeking bifurcation (Wellhead, Clearwood, and Fresno Generation Partners). See, Exhibit 39 to CPUC complaint in Docket No. EL02-60-000.

[35] See Sunrise at 12 n. 24; EPME at 14 (price terms agreed to first, in February, subject to negotiation of acceptable non-price terms).

[36] Sunrise at 38.

respondent. Common issues of law and fact form the basis for the California Board's complaint against each Seller. This reality was recognized by the Commission in the Nevada Power Order's decision to consolidate the complaints in that proceeding.[37]

VIII.

CONCLUSION

For the foregoing reasons, the California Board respectfully requests that the motions to dismiss each be denied, that motions to bifurcate be denied, and that this matter be set for hearing.

Dated: April 15, 2002

Respectfully submitted,

Grant A. Rosenblum

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[37] Nevada Power Order, slip op. at 16 ("Given the overlap of issues and factual inquiries, we will consolidate [the ten complaints filed by the Nevada Companies] as well as Docket Nos. EL02-43-000 and EL02-56-000 into one proceeding for purposes of hearing").

CERTIFICATE OF SERVICE

I hereby certify that I have caused the foregoing document to be served upon each person designated on the official service list compiled by the Secretary for this proceeding on or before April 15, 2002, pursuant to Rule 2010(a) of the Commission's Rules of Practice and Procedure.

Dated at Sacramento, California, this 15th day of April, 2002.

/s/

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